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RENEGOTIATION OF THE INTERNATIONAL NATURAL RUBBER AGREEMENT, 1987

Historical development, status and operation of the International Natural Rubber Agreement, 1987

Note prepared by the UNCTAD secretariat in cooperation with the secretariat of the International Natural Rubber Organization

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INTRODUCTION

1. This note provides, for the information of the Conference, a review of the background leading to the negotiation of the 1987 Agreement, its main features, the current status of the Agreement and a brief summary of the buffer stock operations and other activities which took place under both the 1979 Agreement and the 1987 Agreement.

I. BACKGROUND OF THE 1987 AGREEMENT, ITS MAIN FEATURES AND STATUS

A. The 1979 Agreement

2. The 1987 Agreement was preceded by the International Natural Rubber Agreement, 1979. When the 1979 Agreement was concluded on 6 October 1979, it was widely considered as an important step forward in international commodities negotiations. It was the first new agreement concluded under UNCTAD's Integrated Programme for Commodities and it contained certain innovative features.

3. As compared to Agreements on other commodities, the 1979 Agreement was unusual at the time it was concluded in that it provided for a buffer stock of a maximum size of 550,000 metric tonnes as the sole instrument of market intervention for price stabilization. It thereby excluded export quotas or production controls, which in some other Agreements were important means of, or the only instruments for, price stabilization.

4. Another special feature of the 1979 Agreement was that it was the first commodity agreement in which buffer stocks were financed by direct cash contributions by governments and the costs of the buffer stocks were shared equally by consuming countries and producing countries. Within each group, contributions were assessed in proportion to members' shares in trade.

5. A third special feature of the 1979 Agreement was that it provided for periodic revisions of the price ranges in close relationship to movements in the daily market indicator price (DMIP)[1] and changes in the buffer stock's size. The underlying rationale of this feature was that buffer stock operations could be kept in line with market conditions, and it would be possible to avoid situations where the agreed price limits could not be sustained because the buffer stock was either exhausted or filled.

6. The 1979 Agreement established upper and lower intervention prices demarcating price levels where the buffer stock manager had discretion to act when the DMIP was outside these levels. As seen in chart 1, these intervention price levels were set at ± 15 per cent of the reference price level. The

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[1] The daily market indicator price (DMIP), as defined in both the 1979 and 1987 Agreements, is a composite average of daily official current-month prices on the Kuala Lumpur, London, New York and Singapore markets. It is comprised of RSS1, RSS3 and TSR20 grades of rubber, RSS being ribbed smoked sheet and TSR being technically specified rubber in block form. All quotations are converted to f.o.b. Malaysian/Singapore ports and expressed in a composite Malaysian/Singapore currency.

reference price was set at an initial level of 210 Malaysian/Singapore cents per kilo. The 1979 Agreement also established upper and lower trigger action prices at ± 20 per cent of the reference price, which the buffer stock manager was obliged to defend. A third set of indicative prices established limits which could not be breached through revision of the trigger action prices.

7. The 1979 Agreement established a Committee on Other Measures to promote and seek finance for the development of the natural rubber economy through expanded and improved production, productivity and marketing. Four areas specified are: research and development programmes and projects of benefit to exporting and importing members, including scientific research in specific areas; programmes and projects to improve productivity in the natural rubber industry; ways and means to upgrade natural rubber supplies and achieve uniformity in quality specifications and presentation; and methods of improving the processing, marketing and distribution of natural rubber.

8. The 1979 Agreement, as extended for the maximum period of two years by decision of the International Natural Rubber Council, expired on 22 October 1987. It had as members seven exporting countries accounting for about 95 per cent of world exports and 25 importing countries plus the European Economic Community, which together represented three fourths of world imports at that time.

B. The 1985 Conference

9. At the request of the International Natural Rubber Council, the United Nations Natural Rubber Conference, 1985, was convened to renegotiate the 1979 Agreement.

10. At the first session of the Conference (22 April - 8 May 1985), wide divergences emerged between proposals of exporting countries and those of importing countries, particularly as regards the initial level of the reference price and related price ranges, and the mechanisms for revision of these levels. Exporting countries did not explicitly propose a major change in the means for market intervention such as an export quota or supply restriction scheme to supplement the buffer stock. Underlying the divergences in the views of the groups were basic differences in their conceptions of the role of a commodity agreement for natural rubber.

11. Importing countries held the view that, given practical constraints in operations, the role of an agreement and its buffer stock was essentially to reduce excessive price fluctuations around the trend in market prices. Representatives of main importing countries expressed approval of the way in which the 1979 Agreement had functioned. Despite the most serious recession in decades, the Agreement had kept prices from breaching the lower trigger action price or "must buy" level of the buffer stock manager. Importing countries attributed this success to three main factors: participation in the Agreement of countries representing very high shares of world exports and imports, adequate financing for the buffer stock and a price range attuned to market conditions. Given their generally positive assessment of the 1979 Agreement, they did not wish to see substantial changes in the structure of the Agreement or in its key elements.

12. Exporting countries saw the goals of a new agreement as being not only to stabilize prices by avoiding excessive price fluctuations but, as stated in the 1979 Agreement, to promote balanced growth of supply and demand, and to help to stabilize export earnings and increase these earnings based on expanding export volumes. In particular, they stressed the need to support prices at levels considered as remunerative and just to producers, as well as sufficiently attractive to growers to encourage them to undertake investment in order to ensure orderly growth of the industry in the longer term, since consumption was expected to continue to grow. The price ranges under the 1979 Agreement were too low as inflation had increased production costs since these ranges were negotiated in 1979. Further, the exporting countries asserted that the lower intervention price did not provide a sufficient incentive to ensure that growers would undertake replanting or planting of new areas. They proposed for a new Agreement a large increase in the reference price and narrowing of the width of the price ranges around the reference price.

13. Regarding the semi-automatic revision of the reference price and related price ranges in the 1979 Agreement referred to in paragraph 5, the exporting countries proposed giving more discretionary authority to the Council to determine when and by how much the reference price and related ranges should be revised. They also placed much importance on including movements in the costs of production in the criteria for adjusting these price levels.

14. Negotiations on these issues continued at the second through fourth sessions of the Conference, which were held respectively in May and October 1986 and March 1987. Key economic provisions were negotiated in a series of informal meetings held during these sessions. The President of the Conference also held a number of informal consultations in periods between the sessions. At its final plenary meeting, on 20 March 1987, the Conference established the text of the International Natural Rubber Agreement, 1987.

15. The representatives of 55 states and the European Economic Community participated in the Conference. A number of specialized and related agencies of the United Nations and two intergovernmental organizations participated as observers.

C. Main features of the 1987 Agreement

1. Objectives

16. The objectives of the 1979 Agreement were maintained in the 1987 Agreement. As established in article 1, they are:

(a) To achieve a balanced growth between the supply of and demand for natural rubber, thereby helping to alleviate the serious difficulties arising from surpluses or shortages of natural rubber;

(b) To achieve stable conditions in natural rubber trade through avoiding excessive natural rubber price fluctuations, which adversely affect the long-term interests of both producers and consumers, and stabilizing these prices without distorting long-term market trends, in the interests of producers and consumers;

(c) To help stabilize the export earnings from natural rubber of exporting members, and to increase their earnings based on expanding natural rubber export volumes at fair and remunerative prices, thereby helping to provide the necessary incentives for a dynamic and rising rate of production and the resources for accelerated economic growth and social development;

(d) To seek to ensure adequate supplies of natural rubber to meet the requirements of importing members at fair and reasonable prices and to improve the reliability and continuity of these supplies;

(e) To take feasible steps in the event of a surplus or shortage of natural rubber to mitigate the economic difficulties that members might encounter;

(f) To seek to expand international trade in and to improve market access for natural rubber and processed products thereof;

(g) To improve the competitiveness of natural rubber by encouraging research and development on the problems of natural rubber;

(h) To encourage the efficient development of the natural rubber economy by seeking to facilitate and promote improvements in the processing, marketing and distribution of raw natural rubber; and

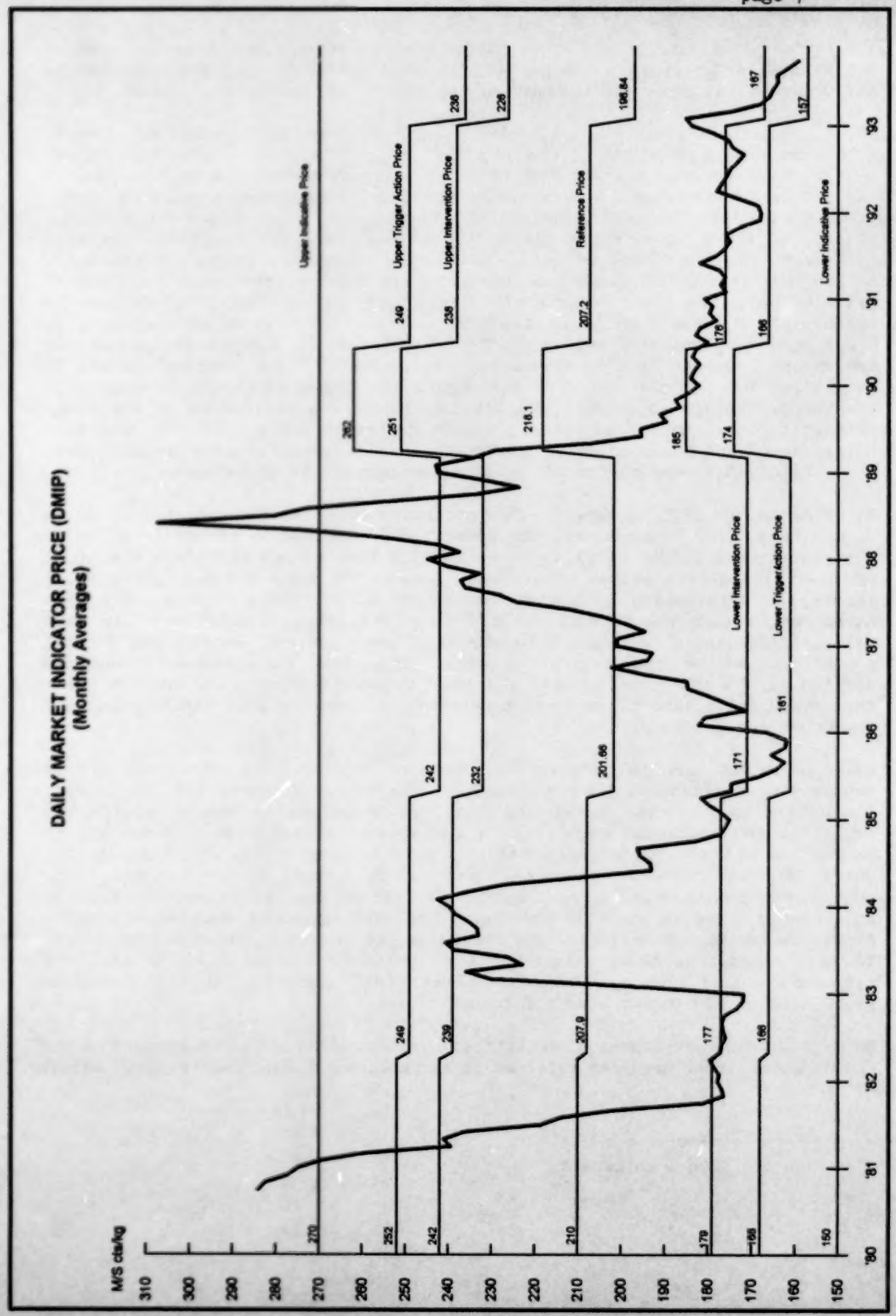
(i) To further international co-operation in and consultations on natural rubber matters affecting supply and demand, and to facilitate promotion and co-ordination of natural rubber research, assistance and other programmes.

2. Operational provisions

17. The operational provisions of the 1987 Agreement are much the same as those of the 1979 Agreement.

18. As in the 1979 Agreement, prices are to be stabilized through the operations of a buffer stock of a maximum size of 550,000 metric tonnes as the sole means of market intervention. The buffer stock consists of a normal buffer stock of 400,000 tonnes and a contingency buffer stock of 150,000 tonnes.

19. The 1987 Agreement maintains the basic structure of the price range. The reference price on entry into force was set at 201.66 Malaysian/Singapore cents per kilo, the current level at that time. As can be seen in chart 1, the upper and lower intervention prices were maintained at ± 15 per cent of the reference price and denote levels above which the buffer stock manager may intervene in the market but is not obliged to do so. The upper and lower trigger action prices were maintained at ± 20 per cent of the reference price and demarcate limits which the buffer stock manager is obliged to defend. Around these price levels, but not specifically related to them, are the upper and lower indicative prices, which are limits that cannot be breached by the trigger action prices when the reference price (and consequently the intervention and trigger action prices)


DAILY MARKET INDICATOR PRICE (DMIP)
(Monthly Averages)
M/S cts/kg
310
300
290
280
270
260
250
240
230
220
210
200
190
180
170
160
150
'80
'81
'82
'83
'84
'85
'86
'87
'88
'89
'90
'91
'92
'93
Upper Indicative Price
270
Upper Trigger Action Price
262
249
242
Upper Intervention Price
251
238
232
Reference Price
218.1
207.2
201.66
Lower Intervention Price
185
174
171
Lower Trigger Action Price
178
168
161
Lower Indicative Price
167
157
252
242
210
179
168
150

are revised. The upper and lower indicative prices were maintained at 270 and 150 Malaysian/Singapore cents per kilo respectively. The composition of the daily market indicator price remained the same as in the 1979 Agreement.[2]

20. Like the 1979 Agreement, the 1987 Agreement contains provisions for semi-automatic revisions of the reference price, based on market price trend and net changes in the buffer stock's size. However, several modifications were made to the revision mechanisms. The reference price is to be reviewed every 15 months instead of every 18 months under the 1979 Agreement. A second modification relates to the size of the revision of the reference price. Under the 1979 Agreement, if at the time of the regular price review the average of the daily market indicator price (DMIP) has been above the upper intervention ("may sell") price or below the lower intervention ("may buy") price, for the preceding six months, the reference price is automatically revised upwards or downwards by 5 per cent respectively, unless the Council decides on a different percentage adjustment. Under the 1987 Agreement, the automatic 5 per cent adjustment is maintained but, unlike the 1979 Agreement, the Council may only decide on a greater percentage adjustment. A similar change was introduced in the semi-automatic provision for adjustment of the reference price by 3 per cent when buffer stock purchases or sales of 300,000 tonnes are effected. In this case, too, the Council may only decide on a higher percentage adjustment.

21. As in the 1979 Agreement, when purchases or sales from the buffer stock reach the 400,000-tonne level, the Council shall decide on the price at which the contingency buffer stock is to be brought into action to defend the upper or lower indicative prices. There was, however, a modification to the price levels for intervening with the contingency buffer stock. Under the 1987 Agreement, unless the Council decided otherwise, these levels were set at 2 Malaysian/Singapore cents per kilo above the lower indicative price and 2 cents per kilo below the upper indicative price. Under the 1979 Agreement, they were defined as the mid-point between the lower trigger action price and the lower indicative price, and the mid-point between the upper trigger action price and the upper indicative price.

22. As under the 1979 Agreement, members of the 1987 Agreement commit themselves to financing the total cost of the buffer stock of 550,000 tonnes. The financing of both normal and contingency stocks is shared equally by exporting and importing countries, and assessments within each group are in proportion to trade, as determined through allocation of votes, including initial votes for each member. The total cost of the normal buffer stock and the contingency buffer stock are to be paid by direct cash contributions made by governments. Unlike the 1979 Agreement, the 1987 Agreement does not contain a provision for borrowing to finance purchases for the contingency buffer stock. The 1987 Agreement nevertheless contains the same provision as in the 1979 Agreement authorizing the Council to take full advantage of the financing facilities of the Common Fund for Commodities.

23. Regarding developmental activities, the functions and areas covered by the Committee on Other Measures referred to in paragraph 7 were maintained. Added

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[2] See footnote 1 on page 3.

to them was development of end-uses of natural rubber through programmes and projects leading to increased and new uses of the commodity.

D. Status of the 1987 Agreement

24. The Agreement was opened for signature from 1 May to 31 December 1987. It entered into force provisionally on 29 December 1988 and definitively on 3 April 1989, the conditions stipulated in paragraphs 1 and 2 of article 60 having been met. The Agreement, originally due to expire at the end of its initial five-year period on 28 December 1993, was extended for a period of one year by decision of the International Natural Rubber Council. Thus, it is currently due to expire on 28 December 1994. It may, however, be extended again for a period of up to one year by a decision of the Council.

25. As listed in the annex to this note, 6 countries are exporting members and 21 countries plus the European Economic Community are importing members. They represent respectively 94 per cent of world exports and 71 per cent of world imports in recent years. Leading exporting countries are Indonesia, Malaysia and Thailand. Major importing countries and groups are China, the European Economic Community, Japan, the Russian Federation and the United States of America.

26. The headquarters of the International Natural Rubber Organization is in Kuala Lumpur, Malaysia.

27. The International Natural Rubber Council, in its Resolution 158 (XXVIII) of 30 November 1993 on renegotiation of the 1987 Agreement, requested the Secretary-General of UNCTAD to convene a United Nations Conference to establish the text of a successor agreement.

E. Preparation for renegotiation of the 1987 Agreement

28. On 22 November 1993, at its twenty-eighth session, the International Natural Rubber Council established a Preparatory Committee to assist the Council in preparation for renegotiation as well as to review the articles in the 1987 Agreement and prepare basic documentation for the Conference.

29. The Preparatory Committee met during the session. The attention of the meeting was drawn to some topics for renegotiation which included:

- the level of the reference price on entry into force of a new agreement;
- the width of the price limits expressed as percentages of the reference price;
- whether there should be "may buy" and "may sell" zones in the price range;
- the levels on entry into force of the upper and lower indicative prices;

- the price levels related to use of the contingency buffer stock;

- the periodicity and percentage of automatic adjustment of the reference price in response to movements of the daily market indicator price (DMIP);

- the amount of net change in the buffer stock that triggers review and revision of the reference price; and

- the components and method of calculation of the DMIP.

II. OPERATION OF THE 1979 AND 1987 AGREEMENTS

A. Buffer stock operations

1. Operations under the 1979 Agreement

30. As seen in chart 1, a year after the 1979 Agreement entered into force in October 1980, the daily market indicator price (DMIP) had fallen by 35 per cent and had entered the buffer stock manager's "may buy" zone. A total of 273,000 tonnes of natural rubber were purchased for the buffer stock to support prices in the 14-month period running from the last week in October 1981 to the end of January 1983.

31. On 8 May 1982, the reference price was revised downward to 207.9 Malaysian/Singapore cents per kilo from its initial level in the 1979 Agreement of 210 cents per kilo. The revision was pursuant to the provision pertaining to the action to be taken when the six-month average of the DMIP was below the lower intervention price, as discussed in paragraph 20.

32. The DMIP unexpectedly soared from the lower intervention price in mid-January 1983 to the upper intervention price in mid-April 1983. It fluctuated around that level to mid-March 1984. Although the DMIP was in the "may sell" zone from time to time, the recovery in demand was not considered strong enough to warrant sales from the buffer stock. The DMIP then fell rapidly from mid-March 1984 to the end of October of that year, although there was a short-lived recovery around July and August 1984.

33. From November 1984 to the first week of May 1985, the DMIP fluctuated around the lower intervention price. Purchases of 3,550 tonnes were made for the buffer stock. From then to the end of the year, the DMIP was near the "must buy" level and over 100,000 tonnes were purchased for the buffer stock to support prices. These purchases brought the total size of the buffer stock to about 357,000 tonnes.

34. On 15 August 1985, the reference price was revised downward to 201.66 cents per kilo in connection with the provision in the 1979 Agreement pertaining to net purchases of 300,000 tonnes referred to in paragraph 20.

35. From January 1986 to August 1987, the DMIP soared from near the "must buy" level to the "may sell" level. It was in the "may sell" zone and above it from the beginning of September 1987 to the third week of March 1989. The entire

buffer stock was sold in this period in an attempt to limit upward price movements. This interval covers the interim period between the expiry of the 1979 Agreement on 22 October 1987 and the entry into force of the 1987 Agreement on 29 December 1988.

2. Operations under the 1987 Agreement

36. When the 1987 Agreement entered into force on 29 December 1988, 25,000 metric tonnes remained in the buffer stock. The daily market indicator price (DMIP) was still in the buffer stock manager's "may sell" zone where it remained through the first quarter of 1989, as seen in chart 1. The 25,000 tonnes in the buffer stock were sold in this quarter as the DMIP continued to be in the "may sell" zone.

37. On 7 April 1989, at the first session of the Council under the 1987 Agreement, the reference price was revised upward to 218.10 Malaysian/Singapore cents per kilo pursuant to the provisions in the Agreement pertaining to the net sale of 300,000 tonnes since the last revision and another provision on revision relating to the average of the DMIP over the previous six months.

38. Market sentiment turned weak in the second quarter of 1989 on reports of slower economic growth and declining sales in the motor vehicle and tyre industries in many of the industrialized countries. As a result, the DMIP fell rapidly into the "may buy" zone by the end of the year, marking the start of a four-year period of low prices.

39. In the first quarter of 1990, 34,500 tonnes were purchased for the buffer stock to support prices as the DMIP remained in the "may buy" zone. The DMIP also remained in that zone during the second quarter. On 10 July 1990, the reference price was revised downward to 207.20 cents per kilo in the revision procedure pertaining to the six-month average of the DMIP. Consequently the "may buy" zone was lowered and the DMIP hovered above it in the second half of 1990. No purchases for the buffer stock were made in the second through fourth quarters of 1990.

40. The world economy continued to suffer from economic recession and conditions in the rubber market were weak and depressed by poor consumer demand. Major automobile and tyre manufacturers reported huge losses and were forced to reduce production. A total of 76,000 tonnes were purchased for the buffer stock in August, October and December 1991 to support prices when the DMIP was in the "may buy" zone. The total size of the buffer stock reached 110,000 tonnes at the end of 1991.

41. Prices remained weak in 1992. A resurgence of demand in the first half of the year was slight and shortlived. The DMIP was in the "may buy" zone for most of the year, rising above it only in April, May and December. A total of 69,000 tonnes was purchased for the buffer stock in August through October to sustain prices, thus bringing its overall size to 179,575 tonnes at the end of 1992.

42. A review of the reference price in connection with the six-month average of the DMIP was held on 29 January and 2 February 1993. The reference price was reduced by 5 per cent, bringing it to a new level of 196.84 Malaysian/Singapore cents per kilo.

43. Purchases for the buffer stock were made in September, October and December 1993. The total size of the buffer stock reached 215,000 tonnes by the end of 1993.

B. Effectiveness of the operations

44. It is generally recognized that purchases for the buffer stock succeeded in their price stabilization objective of supporting the DMIP in the "may buy" zone and preventing it from falling below the lower trigger action price or "must buy" level. This result is clearly seen in chart 1. Buffer stock sales from late 1987 to early 1989 were apparently less successful in defending the upper trigger action or "must sell" level, although the 357,000 tonnes sold helped to meet shortages and limit the high price movements.

45. As regards a basic objective of the 1987 Agreement on achievement of balanced growth of supply and demand there has been widespread and strong criticism in the exporting countries of the low levels of the reference price and price ranges related to it. When the 1979 Agreement entered into force in 1980, the reference price was set at 210 Malaysian/Singapore cents per kilo. Thirteen years later it was actually lower at 196.84 cents per kilo. As a result of low prices and low returns to growers, some producers have abandoned holdings and reduced tappings. Questions have also been raised as to whether there are sufficient incentives for replanting land bearing old unproductive trees with young high-yield trees which are important for security of supplies to consumers as well as for producers' income in the future. National policies relating to replanting and new plantings have had to be reviewed because of the low levels of prices over long periods, particularly the low levels prevailing since 1989. The concept of stabilization of prices around the market trend has been criticized as not meeting the objective of orderly development of the natural rubber economy over the long term.

46. Another basic objective of the 1987 Agreement is to help to stabilize export earnings and increase them based on expansion of export volumes. It is generally recognized that purchases for the buffer stock have supported prices and helped in this way to make export earnings less unstable. Statistical analysis of volumes of exports of natural rubber, with earnings expressed in SDR and unit values as a proxy for price, has shown the following results for the period from 1980 to 1992 which covers the time when both the 1979 and 1987 Agreements were in force. Indonesia had an average gain of 1.7 per cent per year in export earnings as volume increased by 2.4 per cent per year on average while unit value fell by 1.4 per cent per year on average over the period. Thailand's earnings grew by an average of 5.2 per cent per year as volume expanded strongly by an average of 9.9 per cent per year, despite a drop of 4.0 per cent per year in unit value on average over the whole period. Malaysia, on the other hand, suffered an average decline in export earnings of 5.2 per cent per year as volume decreased on average by 2.9 per cent and unit value by 3.1 per cent per year.

Thus, these trends suggest that two of the major exporters have had considerable increases in export earnings based on an expansion of export volumes despite a fall in unit values, while the third major exporter had a serious decrease in earnings as both volume and unit value fell over the 1980 to 1992 period.

C. Other activities

47. With regard to commodity development measures in production, marketing and end-uses of natural rubber, a large number of project proposals have been considered in INRO. The Common Fund for Commodities agreed to provide approximately US$2 million for a project, "Development of blends of natural rubber with specialty elastomers", which was sponsored by INRO and is being carried out by the International Rubber Research and Development Board.

48. INRO has also carried out a range of other developmental activities. One of these efforts was preparation and distribution of directories of polymer science and short management courses. Studies, such as one on natural rubber production and environmental issues, have been undertaken.